REA BOOKKEEPING COURSE

Text No. 3

Journalizing and Posting

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UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Electrification Administration
Finance Division
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JOURNALIZING AND POSTING

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1. INTRODUCTION

Journalizing, or making journal entries, is important in bookkeeping because it concerns the selection of the proper accounts to be debited and credited in order to maintain the fundamental balance between debits and credits. Each business transaction gives rise to one or more debits and one or more credits. Therefore, the most important point to be considered in connection with journalizing is the analysis of the transaction for the purpose of determining its offsetting debit and credit effects. Before making any journal entry, it is essential to study the transaction to determine its effect upon the three major groups of accounting classifications--assets, liabilities, and capital--and the particular accounts increased or decreased.

2. RESULTS OF FINANCIAL TRANSACTION

When we speak of a transaction from an accounting viewpoint, we have in mind the recording of an event that increases or decreases one or more of the three outstanding classes of accounts-assets, liabilities, and capital. Inasmuch as the effect of a transaction is limited to these three groups, and since each group can be affected in only two ways (increased or decreased), it follows that there are only six possible changes that can take place as the result of a business transaction.

We record the effects of a transaction by increasing or decreasing the individual accounts for assets, liabilities, and capital. This is equivalent to increasing or decreasing the entire classification. We increase or decrease an individual account by debits (entries on the left side), and by credits (entries on the right side).

Originally, assets are debited and liabilities and capital are credited, in accordance with the accounting equation $A = L + C$. Thereafter, we debit increases in assets and decreases in liabilities or capital; we credit decreases in assets and increases in liabilities or capital. This may be summarized as follows:

DEBIT:	Increases of Assets	CREDIT:	Decreases of Assets
	Decreases of Liabilities		Increases of Liabilities
	Decreases of Capital		Increases of Capital

This illustrates the fact that three of the six possible changes which can take place as the result of a business transaction are debits and three are credits.

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Since we have previously shown that every journal entry for a transaction involves offsetting debit and credit, it follows that every transaction affects at least one item on each of the above lists. Following this line of thought, we are able to show the combinations that may arise from business transactions:

Dr. Increase in Assets Cr. Decrease in Assets	Examples: Purchase of property for cash; collection of account or note receivable note received to close customer's account.
Dr. Decrease in Liabilities Cr. Increase in Liabilities	Example: Note given to close account payable.
Dr. Decrease in Capital Cr. Increase in Capital	Examples usually found in partnership or corporation accounting. One partner contributes more capital; another withdraws some he had contributed. Or, in the case of an REA cooperative, one member moves from the line and has his membership fee returned while a new member pays in his fee to join the organization.

The transactions above do not affect the total of assets, liabilities, or capital, but involve an exchange of assets, a change in the form of a liability, or a transfer from one capital account to another.

Dr. Increase in Assets Cr. Increase in Liabilities	Examples: Purchase of property on credit; borrowing money from the bank.
Dr. Increase in Assets Cr. Increase in Capital	Examples: Additional investment by owner; income earned for services, or on sales.

Here equal amounts are added to each side of the equation because of assets acquired, and either the creditors' interests or the owner's equity is likewise increased.

Dr. Decrease in Liabilities Cr. Decrease in Assets	Example: Payment of any liability or debt.
Dr. Decrease in Capital Cr. Decrease in Assets	Example: Owner's withdrawals of cash or goods; expenses paid; supplies used.

These transactions subtract from each side of the equation because of assets withdrawn--a decrease of total assets likewise decreasing either liabilities or the proprietor's capital.

Dr. Decrease in Capital
  Cr. Increase in Liabilities
Example: Expenses incurred but not paid.

Dr. Decrease in Liabilities
  Cr. Increase in Capital
Example: Cancelation of debt by creditor.

The combinations do not affect the total of liabilities and capital together, but there is a change in the respective interests of creditors and proprietor in the total assets, which remain unchanged.

A transaction may affect more than one item on each side, in which case a compound entry is necessary, for example:

Dr. Increase of Assets
  Cr. Decrease of Assets
  Cr. Increase of Liabilities
(Purchase of asset, cash down payment, balance on credit.)

In effect, this is a combination of an increase of assets and an increase of liabilities for the purchase price, with a decrease of liabilities and a decrease of assets for the cash payment.

The above analyses apply to any business transaction. In addition to such entries, correcting entries and transfer entries also are made in the journal. Corrections involve cancelation by reversal of the entry in error, followed by proper entry of the transaction. Transfer entries simply change an amount from one account to another, as in certain adjustments and in the closing entries at the end of the period. These will be considered later.

The important thing to keep in mind is that each entry for a transaction must have a debit element and a credit element that balance; and the debit will be an increase of assets, decrease of liabilities or decrease of capital, while the credit must be a decrease of assets, increase of liabilities, or increase of capital.

3. TRANSACTIONS NOT AFFECTING CAPITAL

There are two general classes of business transactions; namely, (a) those that do not affect capital (the excess of assets over liabilities), and (b) those that do affect capital. With respect to the rules of debit and credit, the first group of transactions includes: exchanges of one asset for another; a change in the form of a liability; assets purchased on credit; and payment of a liability.

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4. EXAMPLES OF BASIC TRANSACTIONS

We endeavored in Text No. 2 to present a picture of the initial entry as reflected by the ledger accounts. This text, and those that follow, show how a number of basic transactions are recorded in the ledger accounts already established in order (1) to show how transactions are analyzed for the purpose of journalizing, (2) to trace the development of the ledger from its inception to the end of an accounting period, and (3) to illustrate how the data recorded in the books of account are summarized and presented in the form of financial statements.

With this purpose in view, each journal entry will be preceded by a brief statement showing the financial condition of the business just prior to the occurrence of the transaction upon which the journal entry is based. The accounts of Dan Ross after the initial entry were as follows:

Dan Ross
Balance Sheet January 1, 1939

Assets		Liabilities	
Cash	$ 1,000	Victor Leads	$ 750
John Doe	500	Sam Burns	250
Frank Brown	1,000	Notes Payable	2,000
Inventory	2,500	Mortgage Payable	1,000
Furniture and Fixtures	500		
Building	5,000	Net Worth	
Land	1,000	Dan Ross, Capital	7,500
	$11,500		$11,500

5. ACQUIRING AN ASSET FOR CASH

Transaction No. 1

Dan Ross, the proprietor, on January 2 purchased two show cases for which he paid cash in the amount of $100.00. Further condensing the financial statement, the effect of this transaction upon the elements of the accounting equation is shown as follows:

Cash	$1,000 - $100 =	$ 900	Liabilities	$4,000
Furniture & Fixtures	500 ⨍ 100 =	600		
Other Assets	10,000	10,000	Capital	7,500
	$11,500	$11,500		$11,500

January 2, 1939 (Journal - Page 1)

Furniture and Fixtures	5	100.00	
Cash	1		100.00
Bought two show cases			

Comment:

(a) Dr. Increase of Assets
Decrease of Liabilities
Decrease of Capital

Cr. Decrease of Assets
Increase of Liabilities
Increase of Capital

(b) This transaction gives rise to two occurrences from an accounting standpoint, an increase of assets and at the same time a decrease of assets. Notice how the rule applies to these facts. What has happened is this: An asset value of $100 has been added to the asset classification "Furniture and Fixtures" and simultaneously another asset value of $100 has been subtracted from the asset classification "Cash." Obviously the total asset fund, which we have in mind when applying the rule, is not changed as the result of this transaction. Again comparing the statement of assets, liabilities, and capital to a pair of scales, we may say that this transaction is analogous to taking a pound of sugar from one side of the balance and immediately substituting a pound of coffee.

(c) The page of the ledger account (See Section 10) is inserted in the folio column of the journal when each amount is posted.

6. PURCHASING AN ASSET ON CREDIT

Transaction No. 2

Dan Ross purchased an additional plot of land from Victor Leads on January 2, 1939, for $500.00 on credit. We then have:

Land	$1,000 ⨍ $500 =	$1,500	Victor Leads	$ 750 ⨍ $500 =	$1,250
Other Assets	10,500	10,500	Other Liabilities	3,250	3,250
			Capital	7,500	7,500
	$11,500	$12,000		$11,500	$12,000

(Journal - Page 1)

		-2-						
		Land	7		500	00		
		Victor Leads	8				500	00
		Purchase of lot (description).						

Comment:

(a) Dr. INCREASE OF ASSETS / Decrease of Liabilities / Decrease of Capital — Cr. Decrease of Assets / INCREASE OF LIABILITIES / Increase of Capital

Dr.	Cr.
INCREASE OF ASSETS	Decrease of Assets
Decrease of Liabilities	INCREASE OF LIABILITIES
Decrease of Capital	Increase of Capital

(b) This transaction may be analyzed as follows: The total fund of assets has been increased. The asset land has been acquired; therefore the "Land" account representing the individual asset should be increased by debiting the account with that amount. No other asset has been given in exchange; therefore no asset account can be credited as in Transaction No. 1. Capital has not been increased because by receiving the land Dan Ross has become indebted to Victor Leads who has a claim against Ross for the amount of $500 on account of the transaction. Since two of the three possibilities have been eliminated, the third must apply: that is, liabilities have been increased. The account of Victor Leads, representing a personal account payable, is credited for $500. The transaction has been analyzed in this manner to show that the credit can always be determined if the debit is known, or vice versa, by proper application of the rules given.

(c) Notice in connection with the condensed statement of assets and liabilities that the totals of both sides remain equal. This equality depends upon the mathematical principle that if equals are added to equals the totals will be equal. If the totals are not equal, an error in the contents of the ledger or in the balancing of the accounts is apparent.

7. PAYMENT OF A DEBT

On January 4 Dan Ross gave Sam Burns a check for $250 in full settlement of account:

Cash	$ 900 - $250 =	$ 650	Sam Burns	$ 250 - $250 =	0
			Other Liabilities	4,250	$ 4,250
Other Assets	11,100	11,100	Capital	7,500	7,500
	$12,000	$11,750		$12,000	$11,750

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		Sam Burns	9		250	00		
		Cash	1				250	00
		Settlement of account in full						

Comment:

(a) Dr. Increase of Assets — Cr. DECREASE OF ASSETS
DECREASE OF LIABILITIES — Increase of Liabilities
Decrease of Capital — Increase of Capital

(b) By the payment of $250 Dan Ross has discharged his indebtedness to Sam Burns. The asset Cash is reduced on one side of the equation and the liability represented by the open account of Sam Burns has been reduced correspondingly on the other side. The total of assets has been reduced and also the total of liabilities.

(c) Note with reference to the condensed statement of financial condition that the equality of totals depends upon the mathematical principle that if equals are subtracted from equals the remainders will be equals.

8. SETTLEMENT OF AN ACCOUNT PAYABLE WITH A NOTE

Transaction No. 4

On January 6, 1939, Dan Ross gave Victor Leads a note for $1,250 to run sixty days without interest in order to close the open account:

Cash and Other Assets	$11,750	Victor Leads	$ 1,250	- $1,250 =	0
		Notes Payable	2,000	+ 1,250 =	$ 3,250
		Other Liabilities	1,000		1,000
		Capital	7,500		7,500
	$11,750		$11,750		$11,750

(Journal - Page 1)

		-6-							
		Victor Leads	8	1	250	00			
		Notes Payable	10				1	250	00
		60-day note without interest to close open account.							

Text No. 3

Comment:

(a) Dr. Increase of Assets | Cr. Decrease of Assets
DECREASE OF LIABILITIES | INCREASE OF LIABILITIES
Decrease of Capital | Increase of Capital

(b) The note payable reduces the liabilities of one classification and adds to those of another. The open account claim of the creditor against Ross ceases to exist and Leads acquires a different kind of claim as evidenced by the promissory note.

(c) A separate account entitled "Victor Leads--Note Payable" could have been set up. Since the number of outstanding notes usually is comparatively small, all of them may be brought together under the one account with the title "Notes Payable," and the name of the payee noted in the explanation. When the number of individual notes is large, it may be more practicable to establish a note register, the nature of which will be discussed in a later text.

9. PAYMENT OF AN ACCOUNT RECEIVABLE

Transaction No. 5

On January 7 Frank Brown sent a check for \$400 and a thirty-day note for \$600 without interest to Dan Ross in full settlement of his account:

Cash	\$ 650 +	\$ 400 =	\$1,050		Liabilities	\$4,250
Frank Brown	1,000 −	1,000 =	0			
Notes Receivable	0 +	600 =	600		Capital	7,500
Other Assets	10,100		10,100			
	\$11,750		\$11,750			\$11,750

(Journal - Page 1)

		-7-						
		Cash	1		400	00		
		Notes Receivable	3		600	00		
		Frank Brown	3				1 000	00
		Check and 30-day note without interest to close account.						

Text No. 3

Comment:

(a) Dr. INCREASE OF ASSETS
Decrease of Liabilities
Decrease of Capital

Cr. DECREASE OF ASSETS
Increase of Liabilities
Increase of Capital

(b) This transaction results in three changes in values, two of which are debits and one credit. The asset Cash is increased by the amount received, a new account "Notes Receivable" is opened, and Frank Brown's personal account is closed by crediting it. All notes receivable ordinarily can be carried in the one account. In place of the asset account receivable $1,000, we now have cash $400 and the note receivable $600. While the kinds of assets are changed, total assets remain the same.

(c) Compare this with Transaction No. 1 and notice that both simply are exchanges of asset values.

10. POSTING ENTRIES TO THE GENERAL LEDGER

When the five transactions of Dan Ross have ~~been posted to the proper accounts,~~ his ledger will appear as follows:

Cash (Page 1)

1939						1939					
Jan.	1	Investment	J1	1 000	00	Jan.	2	Fixtures	J1	100	00
	7	Brown on Acc't	J1	400	00		4	Burns on acc't	J1	250	00

John Doe (Page 2)

1939											
Jan.	1	Balance	J1	500	00						

Frank Brown (Page 3)

1939						1939					
Jan.	1	Balance	J1	1 000	00	Jan.	7	Cash and note	J1	1 000	00

Notes Receivable

1939											
Jan.	7	Brown 30 days	J1	600	00						

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Inventory (Page 4)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939											
Jan	1	Investment	J1	2 500	00						

Furniture and Fixtures (Page 5)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939											
Jan.	1	Investment	J1	500	00						
	2	Showcases	J1	100	00						

Building (Page 6)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939											
Jan.	1	Investment	J1	5 000	00						

Land (Page 7)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939											
Jan.	1	Investment	J1	1 000	00						
	2	Lot purchased	J1	500	00						

Victor Leads (Page 8)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939						1939					
Jan.	6	Note	J1	1 250	00	Jan	1	Balance	J1	750	00
							2	Land	J1	500	00
				1 250	00					1 250	00

Sam Burns (Page 9)

Date		Item	F.	Debit		Date		Item	F.	Credit	
1939						1939					
Jan.	4	Cash	J1	250	00	Jan.	1	Balance	J1	250	00

Notes Payable (Page 10)

Date		Item	F.	Debit		Date		Item	F.	Credit	
						1939					
						Jan.	1	O. C. White	J1	2 000	00
							6	V. Leads 60 days	J1	1 250	00

Mortgage Payable (Page 11)

Date		Item	F.	Debit		Date		Item	F.	Credit	
						1939					
						Jan.	1	C. R. Co.	J1	1 000	00

Dan Ross, Capital				(Page 12)
	: 1939			
	Jan. 1 Investment	J1	7	500.00

When the debit and credit items in an account become equal, the account is said to be in balance. The bookkeeper then should close the account by ruling it. Turn to the ledger account of Victor Leads and notice how the two sides have been totaled and double ruling made. Next notice the account of Sam Burns, which carries only one item on each side. The addition line is omitted and the account ruled with double lines only.

11. TRIAL BALANCE

In order to prove the mathematical accuracy of postings to the general ledger, the open balances of each account may be listed as to debits or credits and totaled. This is called a trial balance. Upon listing and adding the balances of the ledger accounts of Dan Ross, we find that the accounting equation of the books has not been disturbed by the transactions that have been journalized and posted:

Dan Ross
Trial Balance
January 7, 1939

(Account Title)	(Debits)	(Credits)
Cash	$ 1,050.00	
John Doe	500.00	
Notes Receivable	600.00	
Inventory	2,500.00	
Furniture and Fixtures	600.00	
Building	5,000.00	
Land	1,500.00	
Notes Payable		$ 3,250.00
Mortgage Payable		1,000.00
Dan Ross, Capital		7,500.00
	$11,750.00	$11,750.00

The trial balance primarily is a check on the bookkeeper's accuracy in posting a debit for each credit, and vice versa. If the trial balance totals do not agree, an error or omission is evident. Equality does not always prove correctness because it is possible for equal amounts of error to exist on both sides, but this seldom occurs as a matter of practice.